

State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Monthly Meeting February 24, 2010

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, February 24, 2010. The Treasurer called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Mr. Andrew Reilly and General Treasurer Frank T. Caprio, establishing a quorum. Also present were Ms. Sally Dowling, of Adler Pollock, & Sheehan and Mr. Joseph Rodio, of Rodio & Ursillo, Legal Counsel to the Commission; Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultants to the Commission; Ms Lisa Tyrrell of State Street Corporation; and members of the Treasurer's staff. Dr. Robert McKenna. Mr. Robert Gaudreau, Ms. Marcia Reback, and Mr. John Treat were not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of January 27, 2010. Mr. Reilly moved, Mr. Michael Costello seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Mr. Andrew Reilly, and General Treasurer Frank T. Caprio.

VOTED: To approve the Minutes of the January 27, 2010 monthly meeting.

General Consultant Report. Mr. Burns asked the group to refer to the handout Statement of Investment Policy for the Economically Targeted Investment Program and specifically the new language in section B, bullet three. This document reflects the board's consensus at the January meeting that the State of Rhode Island should not guarantee these investments.

Treasurer Caprio entertained a motion to adopt the Investment Policy for Economically Targeted Program as presented by Mr. Burns of PCA. Mr. Costello moved, Ms. Booth Gallogly and Mr. Giudici seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Mr. Andrew Reilly, and General Treasurer Frank T. Caprio.

VOTED: To adopt the Statement of Investment Policy for the Economically Targeted Program

Real Estate Review. Mr. Burns introduced Mr. Anthony Frammartino and Mr. Martin Rosenberg from the Townsend Group.

Mr. Frammartino gave a brief history of the program that started in late 2004 with the majority of the capital committed between 2005 and 2006. There were only two commitments (with limited exposure) made

during 2007, 2008, and 2009. He said the program is currently underperforming the benchmark mainly due to investment timing. The 65% allocation to core investments mitigated losses overall within the portfolio relative to riskier strategies investors were pursuing at the time. The current down-turn in this asset class in one year has surpassed that of the early 1990s. At this point in the cycle there has been a severe correction, which may have been overshoot. To the SIC's credit, by design you had a much higher weighting to core strategies, 65% of your portfolio are stable core investments, with low leverage and income flowing, that are well diversified by property type and market.

Treasurer Caprio asked for clarification on the valuation of core assets due to the down-turn.

Mr. Rosenberg replied that the correction from peak to trough for core funds is about 40%. The general view among managers is we are close to a bottom of the correction. This is consistent with what we have seen for over a year, with the valuation metrics that we are seeing, and activities that we are starting to see in the market. The timing of the inception of the portfolio detracted value, however, to some degree, manager selection preserved value.

Mr. Frammartino said that the fund hasn't put any money to work in several years now. There were plenty of investors who used the pause in the market in 2007 as a "buy signal" and put money back in, which was immediately re-priced. To give you an idea of the volatility of the opportunistic funds, we were seeing an average of 50% to 70% write down in some of those strategies.

Mr. Rosenberg stated that this isn't true across the board, but some of the selected managers, shown on a graph on page 11, slowed their commitment pace very significantly, so at the absolute peak in 2007, the fund didn't put that much capital to work when it became clear that we were starting a severe down track.

Mr. Frammartino remarked that the program was conditioned on a 3 to 5 year investment horizon to get to the full allocation target in that time period. We essentially started investing in 2005 and 2006 at a point of very rapidly increasing equity markets. At the end of 2006 we were not actively investing but were monitoring our exposure. Generally you don't time the market, but this proved to be the kind of market where not being in for the last couples of years has worked to our benefit. We think now there are opportunities to continue with the program, to make some attractive investments. We need a clear understanding of what the SIC wants the real estate program to mean to the total plan long term. Historically investors had looked to the asset class to give returns that were higher than fixed income returns and lower than equity risks and real estate had done that. On average your peers have 50 % of their portfolio in core, where Rhode Island has 65 % percent in core, so you are actually a little more conservative.

The group then discussed the aspects of the real estate portfolio presentation and future opportunities.

Ms. Booth Gallogly asked for clarification on how core investments are allocated.

Mr. Rosenberg replied that 65% is invested in the core funds.

Mr. Reilly asked for clarification of the opportunities for the remaining obligations, aside from AEW, Magna Hotel and new commitments in the portfolio.

Mr. Frammartino commented that AEW and Westbrook are great examples of future opportunity. Being able to make new transactions will result in better pricing. Magna is another good example that is already in place in your portfolio. We feel strongly about the lodging opportunity.

Mr. Goodreau noted that we shut down real estate in 2007 – AEW offered a commitment with no leverage and the ability to go to market when the opportunity presents – to their credit the majority of the capital is uncommitted. I believe having the capital in patient hands will pay off, this is the structure we will look for in the next fund we partner with.

Mr. Reilly commented that the portfolio is highly concentrated in the AEW fund and he would like to see diversity through future investments.

Mr. Costello said that we have to be mindful of the structure we have here and the way we operate. We can participate in a reasonable manner but to put additional monies in now is likely unwise.

Mr. Goodreau said that he agrees that this may not be the time to allocate fresh capital into a new fund; a fee incentive should be in place in the fee structure to encourage patience.

Mr. Guidici asked if Townsend had performed any trend analysis studies indicating the peaks and valleys with the time frame for turn around.

Mr. Rosenberg replied they have and the conclusion was each downturn looks different with respect to timing and which property types perform better. This time is different. Townsend expects to see a more protracted recovery than that of 2001 and fewer distressed buying opportunities than in the 1990s resulting in having to make much more focused investments.

Mr. Burns asked about the amount of leverage and how much risk is in this portfolio.

Mr. Frammartino replied that it is in the mid 30s and the leverage is appropriately placed. There is a good profile here. The discussion of the real estate portfolio concluded.

Treasurer Caprio called on Mr. Vincent Izzo and Mr. Patrick Marr to provide information on the short term investment review.

Mr. Izzo told the board that we are looking at potential new providers to take advantage of approved vehicles we don't currently use. He turned the floor over to Mr. Marr who had preformed due diligence on this issue.

Mr. Marr explained that the rationale is to have as many full service brokers at our service as possible to get a more attractive yield for our investments. Accordingly the staff is seeking permission to transact securities business with Oppenheimer & Company. The investment capabilities are collateralized deposits that we are currently empowered to invest in: money markets, repos, certificate of deposits. He said Oppenheimer & Company meets all of the criteria in our investment policy, excluding the issue many of our providers are facing, a positive net income for consecutive 4 quarters. Like

many investment companies, they did show quarters of net consecutive losses in 2008. However, the past 3 quarters have been consecutively positive, 2008 loses have been made up for in calendar year 2009.

Some other requirements are for banks or commercial paper issuers and do not apply. Oppenheimer Trust Company, a subsidiary of Oppenheimer & Company, is amending its charter to become a commercial bank and is applying for FDIC insurance. Therefore they may provide banking services for us in the future.

Mr. Izzo informed the group of the list of products that are approved by the commission and all are fully collateralized or government backed so there is minimal risk being undertaken.

Ms Booth Gallogly asked if the commission should add criteria that would apply to this type of provider.

Treasurer Caprio replied that the staff will identify additional criteria specific to a full service broker.

Mr. Izzo said that the staff will develop other criteria and report back.

Treasurer Caprio entertained a motion to add the broker/dealer Oppenheimer & Company to the short-term investments list and allow them to bid on products. Mr. Reilly moved, seconded by Mr. Costello and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Mr. Andrew Reilly, and General Treasurer Frank T. Caprio.

VOTED: To approve the broker/dealer Oppenheimer & Company to be added to the short-term investments list and allow them to bid on

products.

Legal Counsel Report. Legal Counsel had no report.

Chief Investment Officer Report. Mr. Goodreau reported that for January the fund outperformed the benchmark by 13 basis points. The returns in many areas of the fund are outperforming the benchmark for longer periods of time with the exception of some very short term vehicles that are affected by private equity and real estate. He noted that we are now trending up in positive quarters. Historically this has not been the case.

A major focus currently and in the near future is issuing request for proposals (RFP). We are developing the process for the approved search for alternative managers in the fund to fund space. The staff also recommends a request for proposals for the alternative investments consultant and the real estate consultant.

Treasurer Caprio commented that this is the appropriate time to start the RFP process in these areas.

Treasurer's Report. The focus for the upcoming weeks will be in the cash flow area with the busy season approaching for revenue collections. We will be working with Ms. Booth Gallogly on payments of TANs and new bond issues.

We have received extensive media requests on the fund's 2009 performance because our returns were relatively strong in this environment. The staff will get you copies of the items where the fund

is mentioned.

New Business. There was no new business.

There being no new business, the Treasurer entertained a motion to adjourn. Mr. Reilly moved, Mr. Costello seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Mr. Andrew Reilly, and General Treasurer Frank T. Caprio.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:24AM.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**